

transactions, including any market maker, that would otherwise be entitled to rely on the exception provided in paragraph (b)(2)(ii) of this section, may not accept a short sale order in the threshold security from another person, or effect a short sale in the threshold security for its own account, without borrowing the security or entering into a bona fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity;

(vi) If a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer's short position, then the provisions of this paragraph (b)(3) relating to such fail to deliver position shall apply to the portion of such registered broker or dealer that was allocated the fail to deliver position, and not to the participant; and

(vii) A participant of a registered clearing agency shall not be deemed to have fulfilled the requirements of this paragraph (b)(3) where the participant enters into an arrangement with another person to purchase securities as required by this paragraph (b)(3), and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase.

(c) *Definitions.* (1) For purposes of this section, the term *market maker* has the same meaning as in section 3(a)(38) of the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. 78c(a)(38)).

(2) For purposes of this section, the term *participant* has the same meaning as in section 3(a)(24) of the Exchange Act (15 U.S.C. 78c(a)(24)).

(3) For purposes of this section, the term *registered clearing agency* means a clearing agency, as defined in section 3(a)(23)(A) of the Exchange Act (15 U.S.C. 78c(a)(23)(A)), that is registered with the Commission pursuant to section 17A of the Exchange Act (15 U.S.C. 78q-1).

(4) For purposes of this section, the term *security future* has the same meaning as in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(5) For purposes of this section, the term *settlement day* means any business day on which deliveries of securities and payments of money may be made through the facilities of a registered clearing agency.

(6) For purposes of this section, the term *threshold security* means any equity security of an issuer that is registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78l) or for which the issuer is required to file reports pursuant to section 15(d) of the Exchange Act (15 U.S.C. 78o(d)):

(i) For which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more, and that is equal to at least 0.5% of the issue's total shares outstanding;

(ii) Is included on a list disseminated to its members by a self-regulatory organization; and

(iii) *Provided, however,* that a security shall cease to be a threshold security if the aggregate fail to deliver position at a registered clearing agency does not exceed the level specified in paragraph (c)(6)(i) of this section for five consecutive settlement days.

(d) *Exemptive authority.* Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any transaction or class of transactions, or to any security or class of securities, or to any person or class of persons.

[69 FR 48029, Aug. 6, 2004, as amended at 72 FR 45557, Aug. 14, 2007; 73 FR 61706, Oct. 17, 2008]

#### § 242.204 Close-out requirement.

(a) A participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours on the settlement day following the settlement date, immediately close out its fail to deliver

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position by borrowing or purchasing securities of like kind and quantity; *Provided, however:*

(1) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security and the participant can demonstrate on its books and records that such fail to deliver position resulted from a long sale, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date, immediately close out the fail to deliver position by purchasing or borrowing securities of like kind and quantity;

(2) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security resulting from a sale of a security that a person is deemed to own pursuant to § 242.200 and that such person intends to deliver as soon as all restrictions on delivery have been removed, the participant shall, by no later than the beginning of regular trading hours on the thirty-fifth consecutive calendar day following the trade date for the transaction, immediately close out the fail to deliver position by purchasing securities of like kind and quantity; or

(3) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security that is attributable to bona fide market making activities by a registered market maker, options market maker, or other market maker obligated to quote in the over-the-counter market, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date, immediately close out the fail to deliver position by purchasing or borrowing securities of like kind and quantity.

(b) If a participant of a registered clearing agency has a fail to deliver position in any equity security at a registered clearing agency and does not close out such fail to deliver position in accordance with the requirements of paragraph (a) of this section, the participant and any broker or dealer from which it receives trades for clearance and settlement, including any market

maker that would otherwise be entitled to rely on the exception provided in § 242.203(b)(2)(iii), may not accept a short sale order in the equity security from another person, or effect a short sale in the equity security for its own account, to the extent that the broker or dealer submits its short sales to that participant for clearance and settlement, without first borrowing the security, or entering into a bona fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency; *Provided, however:* A broker or dealer shall not be subject to the requirements of this paragraph if the broker or dealer timely certifies to the participant of a registered clearing agency that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or that the broker or dealer is in compliance with paragraph (e) of this section.

(c) The participant must notify any broker or dealer from which it receives trades for clearance and settlement, including any market maker that would otherwise be entitled to rely on the exception provided in § 242.203(b)(2)(iii):

(1) That the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of paragraph (a) of this section; and

(2) When the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency.

(d) If a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or from which it receives trades for settlement, based on such broker's or dealer's short position, the provisions of paragraphs (a) and (b) of this section relating to such fail to deliver position shall apply to such registered broker or dealer that was allocated the fail to deliver position, and not to the participant. A

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broker or dealer that has been allocated a portion of a fail to deliver position that does not comply with the provisions of paragraph (a) of this section must immediately notify the participant that it has become subject to the requirements of paragraph (b) of this section.

(e) Even if a participant of a registered clearing agency has not closed out a fail to deliver position at a registered clearing agency in accordance with paragraph (a) of this section, or has not allocated a fail to deliver position to a broker or dealer in accordance with paragraph (d) of this section, a broker or dealer shall not be subject to the requirements of paragraph (a) or (b) of this section if the broker or dealer purchases or borrows the securities, and if:

(1) The purchase or borrow is bona fide;

(2) The purchase or borrow is executed after trade date but by no later than the end of regular trading hours on settlement date for the transaction;

(3) The purchase or borrow is of a quantity of securities sufficient to cover the entire amount of that broker's or dealer's fail to deliver position at a registered clearing agency in that security; and

(4) The broker or dealer can demonstrate that it has a net flat or net long position on its books and records on the day of the purchase or borrow.

(f) A participant of a registered clearing agency shall not be deemed to have fulfilled the requirements of this section where the participant enters into an arrangement with another person to purchase or borrow securities as required by this section, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase or borrow.

(g) *Definitions.* (1) For purposes of this section, the term *settlement date* shall mean the business day on which delivery of a security and payment of money is to be made through the facilities of a registered clearing agency in connection with the sale of a security.

(2) For purposes of this section, the term *regular trading hours* has the same

meaning as in Rule 600(b)(64) of Regulation NMS (17 CFR 242.600(b)(64)).

[74 FR 38292, July 31, 2009]

### REGULATION ATS—ALTERNATIVE TRADING SYSTEMS

SOURCE: Sections 242.300 through 242.303 appear at 63 FR 70921, Dec. 22, 1998, unless otherwise noted.

#### PRELIMINARY NOTES

1. An alternative trading system is required to comply with the requirements in this Regulation ATS, unless such alternative trading system:

(a) Is registered as a national securities exchange;

(b) Is exempt from registration as a national securities exchange based on the limited volume of transactions effected on the alternative trading system; or

(c) Trades only government securities and certain other related instruments.

All alternative trading systems must comply with the antifraud, antimanipulation, and other applicable provisions of the federal securities laws.

2. The requirements imposed upon an alternative trading system by Regulation ATS are in addition to any requirements applicable to broker-dealers registered under section 15 of the Act, (15 U.S.C. 78o).

3. An alternative trading system must comply with any applicable state law relating to the offer or sale of securities or the registration or regulation of persons or entities effecting transactions in securities.

4. The disclosures made pursuant to the provisions of this section are in addition to any other disclosure requirements under the federal securities laws.

#### § 242.300 Definitions.

For purposes of this section, the following definitions shall apply:

(a) *Alternative trading system* means any organization, association, person, group of persons, or system:

(1) That constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of § 240.3b-16 of this chapter; and

(2) That does not:

(i) Set rules governing the conduct of subscribers other than the conduct of such subscribers' trading on such organization, association, person, group of persons, or system; or